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April 15, 1997

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

Re: *In the Matters of Federal-State Joint Board on Universal Service and
Access Charge Reform, CC Docket Nos. 96-43 and 96-262*

Dear Mr. Caton:

Today, the attached letter was delivered by the undersigned on behalf of SBC Communications Inc., Pacific Telesis Group, and BellSouth Corporation to the Office of Chairman Reed E. Hundt in connection with the above-referenced proceedings.

Please call me if you have any questions.

Very truly yours,

Todd F. Silbergeld

Attachment

cc: The Hon. Reed E. Hundt
The Hon. James H. Quello
The Hon. Susan Ness
The Hon. Rachelle B. Chong
Mr. Boasberg
Mr. Coltharp
Mr. Casserly
Mr. Gonzalez
Ms. Keeney
Mr. Metzger
Mr. Wright

Ms. Levitz
Ms. Franco
Mr. Peterson
Mr. Moran
Mr. Schlichting
Mr. Nakahata
Mr. Farrell
Mr. Rosston
Mr. Garcia
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April 15, 1997

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Dear Chairman Hundt:

Re: *In the Matters of Federal-State Joint Board on Universal Service and Access
Charge Reform, CC Docket Nos. 96-45 and 96-262*

As you know, the Telecommunications Act of 1996 ("the Act") required the Federal-State Joint Board on Universal Service ("Joint Board") to recommend changes to the Commission's existing regulations to implement new Sections 214(e) and 254. The Act further required the Commission to initiate a single proceeding to implement the Joint Board's recommendations, to complete the proceeding by May 8, 1997, and to establish rules that include a specific timetable for implementation.¹ The Commission appropriately has recognized the need for access charge reform and commenced a proceeding to examine its access charge rules. Although the Act does not specifically address or require access charge reform, universal service and exchange access competition significantly affect the need for access charge rule changes.

On April 4, 1997, AT&T, Bell Atlantic and NYNEX filed a proposal ("Joint Proposal") intended to address the access charge reform and universal service proceedings. In addition, recently you have suggested in several fora an approach to address these issues.² This letter identifies the significant concerns that we have with these alternatives and reinforces the need to adopt the recommendations that we placed on the record on April 2, 1997.

The key component of the AT&T/Bell Atlantic/NYNEX Joint Proposal is a confiscatory \$2.5 billion access revenue reduction that simply does not include an adequate means for recovery. While the Act requires explicit support for universal service, Congress did not mandate the confiscation of incumbent local exchange carrier ("ILEC") revenues. Adoption of this proposal would severely disadvantage the ILECs and further delay delivery of the benefits of competition intended by Congress.

¹ 47 U.S.C. § 254(a)(2).

² B. Gruley, "FCC Chief Asks Postponement of Phone Plan," The Wall Street Journal, April 8, 1997 at A2; Speech of Chairman Reed E. Hundt before the National Association of Regulatory Utility Commissioners Communications Committee, February 25, 1997; Remarks of Chairman Reed E. Hundt at "Convergence or Collision: Telecommunications Regulation and the Internet," Berkeley, CA, March 7, 1997; Statement of Chairman Reed E. Hundt on Universal Service before the Committee on Commerce, Science and Transportation, United States Senate, March 12, 1997.

The ILECs least affected by the Joint Proposal are, not surprisingly, Bell Atlantic and NYNEX. The near term financial effects of this proposal on other price cap ILECs are, in many cases, two or three times, on a percentage basis, as large as the effects on Bell Atlantic and NYNEX. This inequity is even more apparent when the level of switched access prices among the RBOCs is considered. The new Bell Atlantic's weighted average switched access price is \$0.0274 per minute. The consolidated price of \$0.0274 is greater than the per minute switched access price of any of the RBOCs, yet, under the Joint Proposal, the new Bell Atlantic is called upon to reduce its prices the least of any of the RBOCs. Such a result penalizes those companies that have taken the lessons of price regulation to heart and have improved earnings while reducing prices by becoming more efficient. The Joint Proposal simply rewards the inefficiency of the new Bell Atlantic.

AT&T's motivation also is clear. It has no interstate access revenues at stake and stands to gain substantially from across-the-board access rate reductions. The mechanics of the revenue reductions simply reinstate rate of return regulation, which directly abrogates the underlying concepts of the Commission's price cap rules. "Incentive regulation relies in the first instance on regulating prices."³ Price cap regulation was implemented specifically to "harness the profit-making incentives common to all businesses."⁴ Customers have received the benefits of these ILECs' productivity in the form of reduced prices. At the same time, price cap ILECs were given the incentive to increase productivity by removing the cap on earnings that exists with rate of return regulation. Price cap regulation works because it rewards companies that are efficient by allowing these companies to keep any additional earnings that accrue from their efficiencies. By contrast, the Joint Proposal is nothing more than rate of return regulation with a lag. This Commission has previously found that rate of return with a regulatory lag produces none of the gains that incentive regulation provides.⁵

Another significant flaw in the Joint Proposal is in the area of universal service. To satisfy the requirements of the Act: (1) support must be sufficient and predictable;⁶ (2) universal service support must be explicit;⁷ and (3) all interstate telecommunications

³ *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990), para. 22.

⁴ *Id.*, para. 2.

⁵ *Id.*, para. 40.

⁶ 47 U.S.C. § 254(b)(5).

⁷ *Id.* § 254(e).

carriers must contribute on an equitable basis to preserve and advance universal service.⁸ These three fundamental principles of the Act should be used to test the reasonableness of any universal service proposal submitted to the Commission. Currently, the level of interstate universal service support, for all LECs, is approximately \$5.7 billion.⁹ Improperly, the Joint Proposal recommends that only \$300 million of support for large ILECs should be made explicit¹⁰ and completely fails to address the vast majority of the \$4.0 billion in implicit universal service support that is currently contained in switched access prices. This existing, implicit interstate support is used to support affordable universal service in the high cost areas served by these ILECs.¹¹ The funding amount in the Joint Proposal also appears to support the inclusion of internal connections and Internet access in the education discount fund. If so, the proposal goes beyond the intent of the Act and beyond the Commission's authority.

We are equally concerned about the direction you may be heading in universal service and access reform. Based on recent speeches, discussions with industry members, and articles in the press, it is our understanding that you may be considering: (1) subscriber line charge ("SLC") increases on multi-line business and non-primary residence lines; (2) per line charges applied to interexchange carriers ("IXCs"), with a higher charge for business than residence lines; (3) no access charges on unbundled network elements; (4) no high cost funding for non-rural LECs; (5) and no surcharge for recovery of carrier contributions to the new education and health care funds. These alternatives take a minimalist approach that do not match the magnitude of the change intended by the Act nor the significant effects caused by the Interconnection Order.

Increasing the multi-line business and non-primary residence SLCs, and not increasing primary residence SLCs, is also problematic because it is nearly impossible to identify non-primary residence lines. For example, Southwestern Bell identifies more than one line to the same service address as an "additional line" for internal tracking and marketing purposes. These additional lines, however, are not the same as non-primary

⁸ Id. §§ 254(b)(4), 254(d).

⁹ The \$5.7 billion represents the current amounts of: interstate carrier common line revenue (after removal of pay telephone and Long Term Support ("LTS")), plus interstate switch line port costs (approximately 30 percent of interstate local switching revenue), plus USF and Weighted DEM, LTS, Lifeline, and Link-Up.

¹⁰ This amount is approximately equivalent to the level of funding that large price cap ILECs currently receive from the existing high cost Universal Service Fund.

¹¹ Large price cap ILECs serve approximately 81 percent of the lines that have an interstate cost exceeding \$6.00.

lines. Where multiple adults are living in the same dwelling, each may order and be separately billed for telephone service. In this situation, all but the first line would be classified as an additional line, but each of these lines may be primary lines under the Commission's proposed definition. Aside from the definitional issues, acquiring the necessary information from customers would create privacy concerns.¹² Any claim that higher SLCs on non-primary residence lines will be a significant revenue source is also incorrect. Customers can and will easily avoid the non-primary line distinction by self-declaring, through listings in multiple names, using multiple carriers and other means. Finally, the SLC pricing difference will merely promote uneconomic arbitrage, as resellers will simply purchase basic residence service at the primary line price and offer that service to customers for second line purposes.

Your proposal for a new per line charge that ILECs would impose on IXC's on a presubscribed line basis disproportionately burdens business lines in favor of a reduced burden on residential lines. In essence, this asymmetrical treatment continues the pattern of implicit subsidy that the Act was supposed to correct. Further, such a proposal would contradict the Commission's desire for "widespread competition" and competitively disadvantage ILECs as they compete to maintain these business customers. The availability of unbundled network elements that are completely substitutable for access services along with lower priced local interconnection will expose such access prices to significant, and potentially confiscatory arbitrage.¹³ Here again, the estimated revenue opportunities in these recommendations are illusory.

If the Commission implements an interim plan for non-rural local exchange carriers that leaves universal service support implicit in access rates, then the Commission must not jeopardize that support pending resolution. Some portion of the implicit universal service support in access rates should be levied on unbundled network elements if a minimal plan is advanced.

¹² For example, imposition of distinction regarding non-primary residence lines would force ILECs to ask customers invasive questions about living arrangements and relationships among persons sharing the same dwelling, the number of separate households at the same service address, whether local service was being taken from any other service provider, and whether a particular service address was a primary or secondary residence.

¹³ In any market where a long distance carrier has the ability to offer local exchange service to customers, either through facilities-based, resale, unbundled network elements or other forms of competition, it will have an uneconomic financial incentive to recommend that its long distance customers utilize its (or another CLECs') local exchange service, specifically to avoid the ILEC's higher presubscribed line charge. The only opportunity that the ILEC would have to recover its interstate costs would be if some portion of the contribution in access rates is levied on unbundled network elements.

The Hon. Reed E. Hundt
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On April 2, 1997, BellSouth, Pacific Telesis, and SBC submitted an interim proposal (attached) that would produce lower, more efficient access charges by removing the majority of implicit support and replacing it with an explicit, competitively-neutral interstate high cost universal service fund. Sizing the interstate support fund as recommended would allow ILECs to eliminate carrier common line ("CCL") charges and to reduce local switching by the amount of switch line port costs. Although the changes proposed will not completely eliminate the implicit support in access charges, IXCs will see a reduction in their current interstate access costs. The education component contained in the proposal is designed to provide universal service support for telecommunications services provided to schools and libraries. We are also firmly committed to the formation of a voluntary foundation to ensure that additional resources, such as internal connections and Internet access, are available to qualifying educational institutions. The interim proposal provides a measured first step toward reforming access by breaking the "log jam" of positions in the industry, while giving the Commission additional time to solve the difficult issues surrounding universal service and cost recovery. Thus, the interim proposal properly sizes interstate universal service funding requirements, establishes an explicit, competitively-neutral interstate fund, and reforms structural inefficiencies inherent in the current access structure.

The IXCs intend to compete in the local exchange and exchange access markets and the ILECs intend to compete in long distance markets. Congress expects and encourages this competitive outcome, but also required the preservation and advancement of universal service. Congress' balanced approach -- ignored by the Joint Proposal and other ill-conceived, one-sided recommendations -- must be the template for the Commission's actions in the coming weeks.

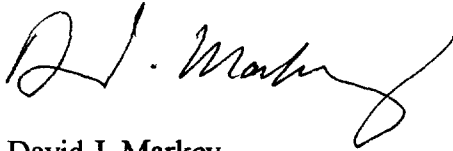
The Hon. Reed E. Hundt

April 15, 1997

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We look forward to the opportunity to discuss this approach with the Commission and stand ready to work with the Commission to solve these complex problems.

Sincerely,



David J. Markey
Vice President - Governmental Affairs
BellSouth Corporation



Thomas O. Moulton, Jr.
Vice President - Washington Operations
Pacific Telesis Group
(a subsidiary of SBC Communications Inc.)



Dale "Zeke" Robertson
Senior Vice President - FCC
SBC Telecommunications Inc.

Attachment

cc: The Hon. James H. Quello
The Hon. Susan Ness
The Hon. Rachelle B. Chong
Mr. Boasberg
Mr. Coltharp
Mr. Casserly
Mr. Gonzalez
Ms. Keeney
Mr. Metzger
Mr. Kennard

Ms. Levitz
Ms. Franco
Mr. Peterson
Mr. Moran
Mr. Schlichting
Mr. Farrell
Mr. Rosston
Mr. Garcia
Mr. Nakahata
Mr. Wright

April 2, 1997

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: *In the Matters of Federal-State Joint Board on Universal Service and Access Charge Reform, CC Docket Nos. 96-45 and 96-262*

Dear Chairman Hundt:

The telecommunications industry and the Commission are faced with the introduction of the various requirements of the Telecommunications Act of 1996, modifications to the access charge structure and the creation of an explicit universal service funding mechanism in a very compressed time frame. The issues are very critical to progress toward a fully competitive industry and the continued provision of universal service. The pressures to reduce access charges, a traditional source of universal service funding, add additional complexities to the task.

In the spirit of continuation and expansion of universal service, reduction of access charges, and the continued progress toward a fully competitive industry, we have prepared and support an interim proposal that contains a series of principles and steps of action that we recommend the Commission include in the upcoming order to be issued on May 8, 1997.

The recommended proposal will produce lower, more efficient access charges by removing the majority of implicit support and replacing it with a competitively neutral interstate high cost universal service fund. The Commission should rely upon known quantities of existing implicit and explicit interstate support to initially size the fund. This should reduce the potential for dissatisfaction because these support flows are generated by current interstate mechanisms. Only the method of allocating funding responsibility need change to ensure contribution to the fund by all interstate telecommunications service providers. The most competitively neutral method by which to accomplish this change would be to allocate funding obligations on the basis of interstate retail revenues. The Commission's adoption of this method would not have to depend on a proxy model to size the fund, but instead could use an existing model to target support. Once this was accomplished, the support per line for the geographic area could be calculated and made portable to all eligible telecommunications carriers serving the area.

Sizing the interstate support fund as recommended would allow incumbent local exchange carriers ("ILECs") to eliminate carrier common line charges and to reduce local switching by the amount of the switch line port costs. The Commission should establish a discrete charge which would apply to interexchange carriers ("IXCs") on a presubscribed line basis to allow ILECs to recover their funding obligation. Although this change will not completely eliminate the implicit support

in access charges, IXC's will see a reduction in their current interstate access charges. As many IXC's and ILEC's have pointed out, only an end user surcharge could totally replace all implicit support currently in access charges and long distance prices.

The proposal also implements several other changes designed to resolve Transport Interconnection Charge ("TIC") issues through price reallocation and establishment of a flat rate charge. This flat rate charge should be applied on a presubscribed line basis similar to the flat rate charge described above. The two charges combined would be capped at \$2.00 per residence or business line. It should be noted that the Commission's recent proposal to assess a higher line charge to business customers would contradict the Commission's desire for "widespread competition" and would competitively disadvantage ILEC's both urban and rural.

Finally, any increases to the current subscriber line charge ("SLC") must be applied uniformly across all lines. In today's environment, it is impossible to accurately identify "secondary lines" because of the variety of uses of each line into the subscriber's residence. Selectively applying an increase based on "perceived" line type is not possible. Application of increases only to business lines is counterproductive to virtually all regulatory efforts at the federal and state levels for the last ten years. Further, increasing the difference between the consumer price of residence and business lines has no logic and no relation to recovery of actual cost. The Commission should consider an affordability criteria that could be used to evaluate the level of the SLC in the long term solution.

In summary, the attached proposal, if adopted as a package, will provide the Commission with a balanced first step to solving the numerous and complex universal service and access reform issues. We look forward to the opportunity to discuss the attached approach with you.

Sincerely,



David J. Markey
VP-Governmental Affairs
BellSouth



Thomas O. Moulton, Jr.
VP-Washington Operations
Pacific Telesis Group
(a subsidiary of SBC
Communications, Inc.)



A. Dale Robertson
Senior VP-FCC
Southwestern Bell Corp.

Attachment

CC: Commissioner James H. Quello
Commissioner Rachelle B. Chong
Commissioner Susan Ness
Mr. James Coltharp
Mr. Daniel Gonzalez
Mr. James Casserly
Mr. Thomas Boasberg
Ms. Regina M. Keeney
Mr. A. Richard Metzger, Jr.
Ms. Kathleen B. Levitz
Mr. John Nakahata
Mr. Joseph Farrell
Mr. James D. Schlichting
Mr. Richard K. Welch
Mr. William F. Caton

UNIVERSAL SERVICE/ACCESS REFORM FOR PRICE CAP COMPANIES

Universal Service - High Cost Fund

1. Size of interim interstate universal service high cost fund based upon interstate carrier common line revenue (after removal of payphone and LTS), plus interstate switch line port costs (approximately 30% of current interstate local switching revenue), plus current USF and weighted DEM, LTS, Lifeline and Link-up.
2. Funding obligation based upon each carrier's share of interstate retail revenues.
3. LEC recovery of funding obligation through presubscribed line (PSL) charge to IXC's.
4. Interstate universal service high cost fund identified by study area. Proxy model used to target support to smaller high cost geographic areas.

Universal Service - Education & Libraries

1. Internal connections and Internet are removed from list of items eligible for universal service support. Size of universal service fund for education/libraries is reduced (from current \$2.25 billion) and supports only discounts on eligible telecommunications services. Fund contributions are recovered through an end user surcharge.
2. Non-profit foundation is created with funding from eight large local exchange carriers that will ensure that a) all classrooms and libraries are wired with 5 connections by the year 2000 and b) all economically disadvantaged and rural schools have access to the Internet.

Access Reform

1. Carrier common line charge reduced to zero.
2. Local switching reduced by switch line port costs (approximately 30%).
3. Presubscribed line charge (PSL) applied to IXC's to recover interstate high cost funding obligation.
4. Transport Interconnection Charge (TIC) reduced by moving service related components to new or existing rate elements.
5. Remaining TIC recovered through TIC PSL charge applied to IXC's.
6. Combined USF and TIC PSL charge not to exceed \$2.00. Any remaining amount recovered through a new TIC usage charge.
7. Price cap productivity changes targeted to TIC usage charge first and then TIC PSL charges.
8. Terminating usage charges would be no higher than originating usage charges.
9. LEC price cap index changes should be based on LEC total factor productivity.
10. When the LEC network is used, LECs are entitled to recover all interstate costs.